November 18, 1930.

KROGER GROCERY & BAKING COMPANY

Capitalization

Funded Debt	-	None
Preferred ($100)	-	$144,000
Common (no par)	-	1,725,726 shs.

Approximate Price (N.Y.S.E.) $20\frac{3}{4}$
Cash Dividend Rate $1.00 Yield 4.8%

Conditions partly within and partly without the company have united to depress Kroger Common to a figure below the net tangible asset value shown by the company's balance sheet. It is our belief that these conditions are temporary and that the company has already seen the worst of them. The soundness of the company and the business in which it engages suggest that investors who have maintained an interest in the stock during its market decline are well justified in continuing their position in the belief that better times are ahead.

Kroger's policy of aggressive expansion built the present organization from one unit in 1883 to a chain of 1500 stores in 1922 and 5575 at the close of 1929. Towards the close of this period, however, it began to appear that the rapid expansion of all grocery chains had brought the industry to a point of diminishing returns. Competition between various units in the field was becoming apparent, introducing elements theretofore non-existent. Accordingly, sweeping expansion programs were halted and attention directed towards consolidation of positions. This, and a major business depression, resulted in a sharp decline in Kroger's earnings during the latter part of 1929 and the first half of 1930.

When the chain store was new, its ability to undersell its less favorably situated competitor was sufficient to assure an adequate sales volume at a fair rate of profit. Under present conditions, no one store holds much advantage over another in this respect. Merchandising and personnel seem to embrace the difference between profitable and unprofitable chains today, and Kroger management is keenly alert to this situation.

Believing that the present number of stores is large enough for the time being, Kroger is intensively engaged in developing its personnel. Courses of instruction in merchandising and store management are being conducted at night for the benefit of employees, with gratifying results. An attitude of inter-dependence and mutual helpfulness seems to have been created between the management on one hand and store managers and clerks on the other.

Consolidating its position during the present year, a number of small, unprofitable units have been discontinued. Merchandise stocks have been reduced to a minimum. Bank loans were fully repaid during the summer without the help of financing. Current position shown by latest published balance sheet was comfortable with current assets of $31,703,595 bearing a ratio of nearly $3\frac{1}{2}$ to 1 of current liabilities. In a business of this type, working capital requirements are not large and the year-end figure of $22,600,000 seems wholly adequate. Further commodity price losses do not threaten to reduce operating income seriously, all known reductions being allowed for during the first half of 1930.

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So long as a company is able to maintain a definitely rising trend of earnings, there is a widespread inclination to project continuance of its growth into the future. This finds expression in a higher price-earnings ratio than obtains for the stock of a company which shows a flattened, trendless earnings curve or one with a downward tendency. As a result, it is not unusual to observe a drastic price decline for a stock upon interruption of an upward earnings trend. Not only do earnings per share form a smaller base for the price-earnings ratio, but, with the trend broken, there is a tendency on the part of the market to reduce the ratio.

Kroger common sold above 132 less than two years ago - thirty two times reported earnings - in recognition of the company's rapid growth in sales and earnings. It has sold as low as 18 this year, not because of financial stringency or embarrassment, but due to an interruption of the upward curve of earnings, a changed market attitude towards the stock, and the declining trend of the market in general. Believing the factors which have interrupted Kroger's progress are capable of solution and will be eliminated in the course of time, we would favor a policy of further retention.

Kroger's earnings averaged between $3.00 and $4.25 per share of common stock during the years 1925-1929. Its position looks physically more secure today than when the shares were selling much above present prices. Of course the glamour of growth is not present to as pronounced a degree. Growth in sales will undoubtedly be less spectacular in the future, but greater regard will be had for the effect of growth on net income.

In conclusion, we believe there is a definite place for the chain store in our economic structure. We have confidence in the ability of Kroger's present management to maintain a prominent position in the field. The stock at present prices appeals to us as well deflated. While near-term price enhancement may be an over-optimistic expectation, we believe substantial appreciation is a probability as the constructive policies which have recently been, and are now being instituted, become apparent in terms of larger earnings per share.

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